VZCZCXRO8721
PP RUEHDBU
DE RUEHTA #0984/01 1080229
ZNY CCCCC ZZH
P 180229Z APR 07
FM AMEMBASSY ASTANA
TO RUEHC/SECSTATE WASHDC PRIORITY 9106
INFO RUCNCIS/CIS COLLECTIVE 0129
RUCPDOC/DEPT OF COMMERCE WASHDC
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C O N F I D E N T I A L SECTION 01 OF 02 ASTANA 000984

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DEPT FOR EB/ESC; SCA/CEN (O'MARA)

E.O. 12958: DECL: 04/16/2015
TAGS: ENRG EPET KZ
SUBJECT: KAZAKHSTAN: AES UPDATES AMBASSADOR ON BUSINESS
INTERESTS, LEGAL ISSUES

REF: A. ASTANA 908

¶B. 06 ALMATY 2054
¶C. ASTANA 580

Classified By: Ambassador John Ordway; reasons 1.5 (b) and (d).

¶1. (C) Summary: AES's Dale Perry told the Ambassador on April 12 that "business is great" in Kazakhstan, despite ongoing legal disputes initiated by regional and local officials, and a general disagreement with regulators over the proper definition of monopoly power. Perry noted that a draft Government of Kazakhstan (GOK) plan for the development of the electricity sector, which confirmed the GOK's intent to fully liberalize electricity prices, was so good "that AES could have written it." Perry confirmed that AES was still pursuing an arrangement to provide 1000 MW to a proposed SUAL (now RUSAL) aluminum smelter in East Kazakhstan; the Chinese appeared to have scuttled a project to build a 7200 MW coal-fired plant in the same region upon being informed by the GOK that they would have to build the plant according to high environmental standards. Perry told the Ambassador that AES's enthusiasm for regional electricity projects had diminished, due to a "lack of evident solutions in Afghanistan," and reduced corporate tolerance for risk. End summary.

AES: Kudos for GOK's Electricity Policy..

¶2. (C) In an April 12 meeting with the Ambassador, Dale Perry, AES's Regional Director for Eastern Europe and the CIS, raved about the GOK's new (draft) plan for the development of the electricity sector, describing the plan as so encouraging that "you would have said AES wrote it." Vice Energy Minister Satkaliyev had underscored the GOK's commitment to price liberalization earlier that day, telling Perry that "we're headed for a free (electricity) market." (Prime Minister Masimov recently told Ambassador that the GOK hoped to achieve full liberalization of the electricity market in 2008. Ref A.) Country Manager Mike Jonagan added that even AES's dealings with its industrial customers were much improved. "They want real, Western-style contracts," he said, adding that the company had not had to take a wholesale customer to court in over two years. In broad terms, Perry concluded, business "was great" in Kazakhstan.

...While Fighting Corruption at the Regional and Local Level

¶3. (C) The most important remaining area of reform, Perry said, lay in the legal definition of a "monopoly" electricity

provider, a concept with important legal implications for the GOK's right to regulate tariffs. AES's most troublesome ongoing legal dispute, Perry explained, arose out of different interpretations of this law, with the GOK's Competition Protection Committee (CPC) arguing that AES had earned illegal monopoly profits in East Kazakhstan as a result of the company's near-dominant position in the oblast. AES, in turn, believes that a company's market share should be assessed from a national, rather than an oblast, perspective.

¶4. (C) Perry told the Ambassador that the newly-appointed akim of East Kazakhstan Oblast, Zhanybek Karibzhanov, had encouraged the CPC to open a criminal investigation of AES's "monopoly profits" in order to pressure AES into lowering electricity tariffs for his new constituents. AES had finally cut a deal with the akim, Perry explained, agreeing to lower tariffs to oblast retail customers by roughly 1 cent per kWh. In return, the authorities agreed to drop the threatened criminal investigation into alleged monopolistic practices by AES employees, including AmCit Jim Doak. The rate cut would cost AES $6 million, Jonagan estimated, but the company had little choice but to settle, as the company could scarcely function if its employees were subject to criminal charges.

¶5. (C) AES was still vulnerable to more than $40 million in civil penalties in the case, Perry noted. Perhaps more disturbingly, the same logic that had been applied to defining a monopoly in East Kazakhstan could be applied in Pavlodar oblast as well, where AES's Ekibastuz GRES I plant represented a far larger investment. AES was pushing the GOK to clarify the monopoly laws, Perry concluded, warning the authorities that, while AES was preparing itself to invest $750 million in the upgrade of its Ekibastuz GRES I plant

(Ref B), it would not undertake the investment until the monopoly laws were clarified.

¶6. (C) Jonagan updated the Ambassador on another legal irritant -- a $3 million assessment against AES for improper storage of overburden at the company's Maikuben mine (Ref C). AES had lost the case in court and on appeal, he explained. However, the company had recently convinced both Finance Minister Korzhova and Environmental Protection Minister Iskakov to listen to a taped conversation of a local environmental official threatening the legal action on the overburden issue if AES didn't pay him a $150,000 bribe. Upon hearing the tape, Jonagan said, both Ministers readily agreed to help facilitate the submission of evidence to the Supreme Court demonstrating that AES had, in fact, followed industry standards in disposing of the overburden. AES was now hopeful, Jonagan concluded, that the Supreme Court would rule in its favor.

Update on AES Business Ventures

¶7. (C) Perry told the Ambassador that AES was still pursuing a deal to sell 1000 MW of electricity to SUAL (Siberian Ural Aluminum Company, now a part of the merged "United Company RUSAL") to power a planned aluminum smelter near Ekibastuz. Since the same company, Access Industries, owned both AES's largest coal supplier, Bogatyr Access Komir, and 30% of SUAL, Perry explained, AES's sale of electricity to the smelter would constitute a "tolling" arrangement, with United Company RUSAL essentially "renting" two of AES's Gres I 500 MW generating blocks to transform its own coal into electricity. However, Perry noted, there was talk of including Bogatyr Access Komir in the "United Company RUSAL" deal. If that happened, Perry said, the GOK might exercise its "preemptive rights" to buy some or all of Bogatyr Access Komir, rendering the "tolling" agreement more complex.

¶8. (C) Asked for news on the Chinese initiative to build a

7200 MW coal-fired plant in NE Kazakhstan (Refs B,C), Perry told Ambassador Ordway that the project appeared to be "dead." The GOK insisted that the Chinese build the new plant to modern, high environmental standards, Perry said. The Chinese objected, arguing that they shouldn't be held to a higher standard than the existing, "dirty" coal plants in the region (including AES's GRES I). However, Perry concluded, the GOK hadn't backed down, and the deal appeared to be dead. (In an April 10 conversation with Ambassador Ordway, Presidential Advisor Vladimir Shkolnik confirmed that the Chinese initiative had lost momentum.)

¶9. (C) Perry voiced skepticism about AES's involvement in efforts to deliver Central Asian power to Afghanistan and Pakistan. AES might be interested in investing in CHP (combined heat/power) plants in Kyrgystan, he said, but "we see no solutions in Afghanistan," and thus had dwindling interest in Tajikistan. AES's (forced) sale of Electricidad de Caracas in Venezuela, he explained, had significantly lowered the company's tolerance for risk elsewhere. "Maybe we would still look at a project bringing electricity north to Almaty," he concluded.
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